IN THE

Supreme Court of the United States

October Term, 1940

No. 101

HENRY F. DU PONT, *Petitioner*

v.

GUY T. HELVERING, *Commissioner of Internal Revenue*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

Reply Brief for Petitioner

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This case was submitted upon a stipulation of facts. That stipulation was adopted by the Board of Tax Appeals as its finding of facts. Consequently, the questions involved are questions of law arising from undisputed facts.

The bulk of the argument in the brief of the respondent is directed to showing that the parties to the transaction intended that a short sale should be made and that the transaction was recorded on the books of account as a short sale. This is conceded and was conceded below. The application for certiorari is based upon the ground that intention and book-

keeping cannot control over the actual facts;[1] that the stipulated facts in this case show that there was in fact no short sale but a sale and delivery of stock which had been owned by the petitioner for more than two years, and that in following the intention and bookkeeping, and in giving no effect whatever to the actual facts of the transaction, the Circuit Court refused to follow decisions of this Court and decisions of other circuits. The Circuit Court did not even mention such decisions, although they were brought to its attention. In such circumstances, this Court has granted certiorari. *du Pont* v. *Commissioner*, 308 U. S. 488.

The facts with respect to the transaction are set out in ¶ 20 of the stipulation [R. 28, 29]:

> "* * * the New York Office of Laird, Bissell & Meeds received from the Bankers Trust Company through the Stock Clearing Corporation 62,500 shares of common stock of E. I. du Pont de Nemours & Co. consisting of stock certificates numbered E-246118 for 2,500 shares, E-9197 for 30,000 shares, E-90414 for 10,000 shares, E-147003 for 10,000 shares and E-147004 for 10,000 shares, all registered in the name of the petitioner, and accompanied by blank powers of attorney for transfer properly endorsed by the petitioner. * * * The certificates which Laird, Bissell & Meeds received from the Bankers Trust Company were delivered to the transfer agent of E. I. du Pont de Nemours & Co. on April 21, 1932, and new stock certificates were received by Laird, Bissell & Meeds from the transfer agent the same day numbered 102198 to 102822, inclusive, for

[1] *Davidson* v. *Commissioner*, 305 U. S. 44; *Doyle* v. *Mitchell Bros.*, 247 U. S. 179.

100 shares each, all in the name of Laird, Bissell & Meeds.

"On the same day, namely, April 21, 1932, Laird, Bissell & Meeds delivered to J. P. Morgan & Company 622 stock certificates for 100 shares each, and 11 stock certificates aggregating 300 shares, of the common stock of E. I. du Pont de Nemours & Co., * * *. Of the stock certificates delivered by Laird, Bissell & Meeds to J. P. Morgan & Company on April 21, 1932, 405 of such certificates, representing 40,500 shares of common stock of E. I. du Pont de Nemours & Co., were part of the series of certificates numbered 102198 to 102822, inclusive, for 100 shares each, previously on the same day issued in the name of Laird, Bissell & Meeds by the transfer agent of E. I. du Pont de Nemours & Co. in exchange for certificates numbered E-246118, E-9197, E-90414, E-147003 and E-147004 as above set forth in this paragraph."

Exhibit A-2 of Exhibit C [R. 77] shows such stock to have been acquired by the petitioner more than two years prior to the sale.

The quotations above from the stipulation are the facts with respect to the identity of the stock delivered on the sale. The balance of the stipulation relates either to other transactions which were admittedly short sales and are no longer in dispute,[2] or to the bookkeeping used in recording this transaction. The entire point of the case, which seems to have been lost upon the Circuit Court and in the respondent's brief in opposition, is that the stipulated facts show that what was intended to be, and was recorded as, a short

[2] Such other transactions fall within *du Pont* v. *Commissioner*, 98 F. (2d) 459, certiorari denied, 305 U. S. 631.

sale was actually executed in such manner as to make the transaction a sale by petitioner of his long stock.

In *Davidson* v. *Commissioner*, *supra*, the taxpayer had sold stock and had instructed his bank to deliver certain certificates upon such sale. The bank erroneously delivered other certificates which had a different basis for tax liability. This Court held that the tax liability was to be determined upon the basis of the actual delivery and that neither intent nor instructions could control.

Here the brokers had been instructed not to deliver the stock of the petitioner, but to make delivery out of borrowed stock. Had these instructions been followed, the case would have been identical with *du Pont* v. *Commissioner*, 98 F. (2d) 459, certiorari denied, 305 U. S. 631, upon which the respondent relies. But, as in the *Davidson* case, those instructions were not followed. Delivery, to the extent of 40,200 shares, was made with the stock of the petitioner.

Taxation is based upon actualities. It is a poor rule which does not work both ways. If taxpayers are to be charged with a tax resulting from a mistake of an agent, they should not be penalized when another mistake results in a lower tax than would have resulted had instructions been followed. The Circuit Court decision is directly contrary to the decision in the *Davidson* case and many similar Circuit Court cases.

Respondent states that this Court has already denied certiorari under similar facts, citing *du Pont* v. *Commissioner*, 98 F. (2d) 459, certiorari denied, 305 U. S. 631. The respondent is mistaken in stating that the

facts were similar. In that case it appeared that when sales were made, borrowed stock was delivered. The taxpayer there did not part with his stockholdings until months after the short sale had been consummated by delivery of borrowed stock, and the question was whether the act of the petitioner in covering the short sales with the long stock had changed the nature of a transaction which was admittedly executed and carried out as a short sale.

Here there is no such situation. The petitioner had owned stock of Du Pont Company which was held by Bankers Trust Company as collateral. The sale to Christiana Securities Company was made by delivering 40,200 shares of this stock. Although first transferred out of the name of the petitioner and into the name of the brokers, the delivery was made with petitioner's stock and not, as in the case cited, with stock borrowed by the broker from others.

Respondent urges that because petitioner's stock was first put into the name of the brokers, it was no longer the stock of petitioner and that delivery was made with stock owned by the brokers.[3] But what title did the brokers have to deliver? They must have acquired that title either by

(a) buying the stock from the petitioner, or
(b) borrowing the stock from petitioner.

If they bought it from petitioner, then there was a sale by petitioner to the brokers of his long stock and

[3] Although differing on the facts, the principles followed in the decision below clash with the principles governing the decisions in *Northwest Utilities Corp.* v. *Helvering* (C.C.A. 8th), 67 Fed. (2d) 619; *Taylor Oil & Gas Co.* v. *Commissioner* (C.C.A. 5th), 47 Fed. (2d) 108; and *Boggs-Burnam & Co.*, 26 B.T.A. 988, affirmed per curiam (C.C.A. 6th) 71 Fed. (2d) 999.

the gain realized was capital gain. If the brokers borrowed it from the petitioner, then

> (c) the brokers made the sale to Christiana acting as principals, in which case the petitioner made no sale until August when the brokers acquired his long stock to cover their borrowing, or
>
> (d) if the brokers were acting as agents, they immediately reloaned to the petitioner the stock which they had borrowed from the petitioner. In other words, the agent borrowed stock from the principal for the purpose of loaning such stock to the principal, to be used by the agent in consummating a sale made by the principal. Or, to put it more briefly, the petitioner must have borrowed his own stock to complete the sale which he had negotiated.

If the principles laid down in the decision of this case are sound, there is no reason why anyone should ever pay a tax upon the profit from the sale of any security. Assume that individual "Z" owns stock of Corporation X which had cost Z $25,000 but which today can be sold for $250,000. Z arranges the sale, but before making delivery Z transfers the stock to a broker. The broker enters the stock in a long account. The broker causes the stock to be transferred to his name, makes delivery to the purchaser with such stock, receives the purchase price of $250,000, records Z's account as short for the same amount of stock and credits Z with $250,000, the proceeds of the so-called short sale. The purchaser has the stock, Z has the sales price, and Z is recorded on the books of the broker as both long and short of the same stock. Obviously the broker has no gain or loss to report as he has sold

at the same price at which he purchased. The respondent and the Circuit Court say that Z would have no gain or loss until Z caused the long and short accounts to be offset. But there is no reason why Z should ever cause this to be done, as the accounts are in perfect balance and offset each other. There never would be a tax on the transaction. The result is ridiculous. Clearly, Z's stock has been sold and delivered, the stock is no longer his, he has received the proceeds, and, under the decision of this and other courts, he cannot postpone or entirely escape the tax by the device of having his broker record the transaction as a short sale of his own stock. But, if the instant case is a proper interpretation of the law and the decisions of this Court, Z has no tax to pay although his own stock is the only stock involved in the transaction.

It is not contended that where there is a true short sale of stock and the taxpayer continues to own an equal amount of the same stock, the same rule would apply. In such a case the taxpayer has all the rights of an owner in the long stock, including the right to vote it and receive dividends. He has an obligation to deliver stock borrowed by his broker from a third person. Sooner or later the transaction will have to be closed, for the third party will demand delivery. But where, as in the instant case, the petitioner's own stock is used to make the delivery, there is no such situation. Could the petitioner have voted the stock which had been delivered in the instant case? Would the Du Pont Company pay him a dividend on it? Obviously not. The only person entitled to vote the stock was the purchaser and the person who had lost

the right to vote was the petitioner. The person who would receive the dividends was the purchaser. All rights to the stock had passed from the petitioner to the purchaser and the petitioner had the proceeds of the sale.

This Court should grant the petition for certiorari, and remand the case to the Circuit Court with instructions to render a decision consistent with the decision of this Court in *Davidson* v. *Commissioner*, *supra*, *Doyle* v. *Mitchell Bros.*, *supra*, and the decisions of the circuit courts which have followed those decisions. See *Deputy* v. *du Pont*, 308 U. S. 488, quoted at page 8 of the petition for certiorari.

Respectfully submitted,
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June, 1940.